



Public Service Commission

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RECORDS AND REPORTING

DATE: JUNE 8, 2000

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF ECONOMIC REGULATION (WILLIS, RENDELL, CASEY) *W*
DIVISION OF LEGAL SERVICES (BRUBAKER) *JB*

RE: DOCKET NO. 980670-WS - INVESTIGATION OF POSSIBLE
OVEREARNINGS BY SANLANDO UTILITIES CORPORATION

DOCKET NO. 971186-SU - APPLICATION FOR APPROVAL OF REUSE
PROJECT PLAN AND INCREASE IN WASTEWATER RATES IN SEMINOLE
COUNTY BY SANLANDO UTILITIES CORPORATION

COUNTY: SEMINOLE

AGENDA: 06/20/2000 - REGULAR AGENDA - PROPOSED AGENCY ACTION
EXCEPT ISSUES NOS. 1 AND 5 - INTERESTED PERSONS MAY
PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\980670.RCM

CASE BACKGROUND

Sanlando Utilities Corporation (Sanlando or utility) is a Class A water and wastewater utility located in Altamonte Springs, Florida, which operates three water and two wastewater plants. Sanlando's service area lies within the St. John's River Water Management District (SJRWMD), which has declared its entire district as a water use caution area.

By Order No. PSC-92-1356-FOF-WS, issued November 23, 1992, in Docket No. 900338-WS, the Commission approved a water conservation plan for Sanlando, which plan includes the construction of an

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effluent reuse system. As required by that order, Sanlando filed a petition for a limited proceeding to implement the water conservation plan on March 10, 1993 in Docket No. 930256-WS.

On December 10, 1993, the Commission issued Proposed Agency Action Order No. PSC-93-1771-FOF-WS, approving Sanlando's petition and requiring the utility to file a proposed charge for reclaimed water. Moreover, the Commission authorized increased gallonage charges in order to generate revenue for the conservation plan and required the utility to establish an escrow account to deposit those funds and any excess revenues.

Several timely protests were filed to Order No. PSC-93-1771-FOF-WS, and the Office of Public Counsel (OPC) and SJRWMD intervened in the docket. Consequently, the matter was set for formal hearing. The parties reached a settlement and submitted a proposed stipulation to the Commission for approval, which they later revised. The overall goal of the stipulation was to fund the construction of the proposed reuse facilities without incurring income tax liability, and thereby reduce the total cost of the project by approximately 40%. To accomplish this goal, the parties agreed to create a non-profit corporation which would own the reuse facilities and which would seek tax exempt status from the Internal Revenue Service (IRS). By Order No. PSC-95-0536-S-WS, issued April 28, 1995, the Commission approved the revised stipulation, with modifications, and ordered the docket to remain open pending the issuance of an IRS letter ruling on the parties' proposed plan. The Commission ordered the parties to report the results of the IRS ruling to the Commission, and authorized the parties to implement the terms of the stipulation if the ruling were favorable to the proposed plan. By Order No. PSC-95-1213-S-WS, issued October 2, 1995, the Commission modified Order No. PSC-95-0536-S-WS, striking a paragraph unrelated to the IRS ruling and substituting new language in its place, and otherwise affirmed the order. Sanlando requested a tax ruling by letter dated June 15, 1995, to the IRS. The IRS letter ruling, dated March 15, 1996, ruled that the monies received by the utility in connection with the reuse facility would not qualify as contributions to capital.

On September 10, 1997, the utility filed a Motion to Hold Docket No. 930256-WS in Abeyance Pending Commission's Ruling on Application for Approval of Reuse Project Plan and Increase for Wastewater Rates. By Order No. PSC-97-1460-PCO-WS, issued November 19, 1997, the Commission granted Sanlando's motion and ordered that Docket 930256-WS be held open in monitor status pending a ruling on the merits of Sanlando's application filed in Docket No. 971186-SU.

On September 11, 1997, Sanlando filed an Application for Approval of a Reuse Project Plan and Increase in Wastewater Rates (Docket No. 971186-SU - new reuse application), which proposed to undertake the reuse project through the use of borrowed capital. The applicant's SJRWMD Consumptive Use Permit Number 2-117-0006UR2 and proposed renewal of its Florida Department of Environmental Protection (DEP) Wastewater Permit Number FL0036251 require that the utility implement a reuse program. To satisfy the permit conditions, the utility proposed to construct a reuse treatment facility along with reuse transmission and distribution mains. The project was designed to provide reclaimed water to four commercial customers (three golf courses and a commercial nursery). The applicant requested that the Commission establish reuse rates and increase wastewater rates to recover the initial cost of the reuse project. When reuse customers were hooked-up and the utility started receiving reuse revenue, the utility proposed to partially reduce the wastewater rates.

The utility's application was filed pursuant to Section 367.0817, Florida Statutes, which provides that all prudent costs of a reuse project shall be recovered in a utility's rates. The Florida Legislature has found that reuse benefits water, wastewater, and reuse customers. Section 367.0817(3), Florida Statutes, requires the Commission to allow a utility to recover all prudent costs of a reuse project from the utility's water, wastewater or reuse customers, or any combination thereof, as the Commission deems appropriate. Therefore, while the utility proposed that the entire cost of the reuse project be recovered from its wastewater rates initially, the Commission may find it appropriate for the costs to be shared in a different manner.

On September 23, 1997, a deficiency letter was sent to the utility outlining minimum filing requirement deficiencies in the utility's application. The utility subsequently corrected the deficiencies and an official filing date of October 16, 1997 was established.

By Order No. PSC-97-1337-PCO-SU, issued October 27, 1997, the Commission acknowledged the intervention of OPC. By Order No. PSC-97-1582-PCO-SU, issued December 17, 1997, the Commission granted intervention by SJRWMD.

On December 10, 1997, the Commission received a draft customer notice from the utility for the originally-scheduled January 7, 1998 customer meeting. While reviewing the proposed customer notice, staff noticed that the rates were different from the rates in the original utility filing. After discussions with the

utility, staff discovered that the utility, without notifying the Commission staff, revised the original filing by including an additional 300,000 gallons per day potential reuse customer that was unknown at the time of the original filing. Also, since the original filing, the utility received and submitted actual pumping data from the golf courses who are potential customers for the reuse system.

The revisions to the utility's original filing were substantial enough to require the resetting of the five-month statutory timeclock by which the Commission is required to enter its proposed agency action (PAA) vote to approve or disapprove the utility's reuse project plan, pursuant to Section 367.0817(2), Florida Statutes. Staff reviewed the revised data, found that minimum filing requirements required by Section 367.0817, Florida Statutes, had been met, and established a new official filing date of December 15, 1997.

A customer meeting was held in the utility's service area on March 4, 1998. Staff conducted an afternoon meeting with representatives of the three golf courses who are proposed reuse customers, and officers of four homeowners associations representing over 4,100 water and/or wastewater customers of the utility. Also present were representatives of SJRWMD, DEP, and OPC.

The general customer meeting was held at 6:30 p.m. and attended by eight customers. PSC staff explained the proposed reuse project, the proposed rate increase, and the PAA and hearing process. Four customers commented on the proposed reuse project and quality of service of the utility. A representative of the Sweetwater Oaks Homeowners Association (SOHA) was present and gave comments regarding the reuse project and the affect it will have on the residents of the Sweetwater Oaks subdivision.

Based upon staff's review of Sanlando's 1996 annual report, staff conducted an investigation of possible overearnings on a going forward basis for Sanlando's water and wastewater systems. After examining the utility's 1996 annual report and completing a benchmark analysis, staff completed a limited scope audit of certain 1996 operation and maintenance expenses. The utility filed a response to staff's audit on March 18, 1998. On April 17, 1998, OPC filed "Citizen's Comments on Sanlando's Reuse Application", and on April 24, 1998, the utility filed its "Response to Citizens" Comments on Sanlando's Reuse Application."

A recommendation concerning Sanlando's reuse application was filed on April 30, 1998, and scheduled to be brought before the Commission at the May 12, 1998 agenda conference. Staff recommended the reuse project plan be approved, but that the monies to fund the project should come from existing revenues because of overearnings of \$219,142 (10.84% of total water revenues) in water revenues and \$301,883 (10.57% of total wastewater revenues) in wastewater revenues in 1996. Staff recommended that all overearnings be held in escrow.

On May 11, 1998, the utility sent a "Response to Commission staff's memorandum dated April 30, 1998", and requested a deferral of the recommendation for two months "to enable the utility time to respond more fully to the staff's recommendation and also provide additional information regarding financing requirements and other matters which the utility believes will be helpful to the Commission in deciding the relevant issues". The Chairman's Office deferred the item by memorandum dated May 11, 1998.

The utility's 1997 annual report was received on May 1, 1998. Due to the observations made in Docket No. 971186-SU concerning overearnings, staff completed an expedited review of the annual report. By Order No. PSC-98-0892-PCO-WS, issued July 6, 1998, in this docket, the Commission initiated an investigation into the utility's rates and charges, ordered the utility to hold 5.17% of water revenues and 9.86% of wastewater revenues subject to refund, and required security in the form of a corporate undertaking to protect the potential refund. Additional revenues were subject to refund because of price indexes initiated in 1996 and 1997. On July 21, 1998, the utility timely filed a motion for reconsideration of that Order. By Order No. PSC-98-1238-FOF-WS, issued September 21, 1998, the Commission denied Sanlando Utilities Corporation's Motion for Reconsideration of Order No. PSC-98-0892-PCO-WS.

On July 29, 1998, Utilities, Inc. filed an application for transfer of majority control of Sanlando Utilities Corporation to Utilities, Inc. By Order No. PSC-99-0152-FOF-WS, issued January 25, 1999, in Docket No. 980957-WS, the Commission approved the transfer of majority control.

On April 7, 1999, staff attended a presentation at the Altamonte City Commission Chambers by representatives of Sanlando and the City of Altamonte Springs (City). The purpose of the presentation was to inform all interested persons that Sanlando and the City were in the process of developing a revised reuse project plan which would have Sanlando interconnect with the City's reuse

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system. Staff was advised that this proposal may include golf courses and a commercial plant nursery which would be connected from the reuse line constructed to the City's reuse lines. At that time, staff was advised that the timeframe included 90 days for City Commission approval, six to nine months of design, and 18 months of construction.

By Order No. PSC-00-0111-PAA-WS, issued January 12, 2000, the Commission ordered Sanlando to credit water CIAC in the amount of \$138,460, and wastewater CIAC in the amount of \$260,432 to reflect 1997 and 1998 overearnings which were held subject to refund plus interest. The Commission also ordered the utility to continue to hold 5.17% of annual water and 9.86% of annual wastewater revenues subject to refund as required by Order No. PSC-98-0892-PCO. In addition, it ordered Sanlando's parent company (Utilities, Inc.) to continue to maintain the existing corporate undertaking on behalf of Sanlando as guarantee of any potential refund of revenues pending the outcome of an analysis of the utility's 1999 earnings.

By Order No. PSC-00-0112-PAA-SU, issued January 12, 2000, the Commission ordered Sanlando to file a revised reuse project application within six-months of the effective date of that order. On March 10, 2000, Sanlando filed an "Amended Application for Approval of Reuse Project Plan" The \$5,831,000 plan calls for Sanlando to interconnect with the City's reuse system, and offer reuse to two golf courses, two homeowner's associations' common areas, and a commercial nursery. The utility did not file its amended reuse plan under Section 367.0817, Florida Statutes (Reuse Projects), and is not proposing to recover the cost of the reuse project through rates. Therefore, a five-month statutory timeframe critical date does not apply. Sanlando states that its investment will eliminate any question of overearnings for the year 2000 and beyond. Construction is scheduled to commence this month, and be completed by the end of 2001.

On March 13, 2000, Sanlando filed a "Motion to Close Docket 980670-WS", proposing that it book any 1999 overearnings as CIAC consistent with the Commission's prior actions, and that this docket be closed. The motion also proposed that as of January 1, 2000, no earnings be held subject to refund, and that the corporate undertaking be terminated.

On March 24, 2000, OPC filed a "Citizens response to Sanlando's Motion to close Docket No. 980670-WS", strongly objecting to Sanlando's Motion, and recommending denial of Sanlando's Motion to close Docket No. 980670-WS, to credit 1999

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overearnings to CIAC, and to not require Sanlando to hold revenues for the year 2000 subject to refund.

On April 14, 2000, a noticed conference call was held between the utility, staff, and OPC to review the utility's Motion. The utility confirmed that it would agree to credit CIAC for the amount of monies held subject to refund for 1999 (\$407,009), provided the Commission would not require the utility to hold revenues subject to refund after January 1, 2000, the Commission would terminate the corporate undertaking, and the Commission would not conduct an audit of 1999 utility books.

This recommendation addresses Sanlando's Motion to Close Docket No. 980670-WS, the Citizen's Response to Sanlando's Motion, and Sanlando's "Amended Application for approval of Reuse Project Plan."

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission consolidate Dockets Nos. 980670-WS and 971186-SU?

RECOMMENDATION: Yes, Staff believes that consolidation of Dockets Nos. 980670-WS and 971186-SU would promote the just, speedy, and inexpensive resolution of the proceedings, and would not unduly prejudice the rights of any party. Accordingly, staff recommends that the Commission consolidate Dockets Nos. 980670-WS and 971186-SU. (BRUBAKER, CASEY, RENDELL)

STAFF ANALYSIS: As discussed previously in the case background, there are two open dockets which address Sanlando's reuse project (971186-SU), and overearnings (980670-WS). Staff believes that the dockets should be addressed simultaneously since Sanlando is proposing to offset any overearnings in 2000 with the costs of the reuse project which will start construction in June 2000.

Rule 28-106.108, Florida Administrative Code, provides that "[i]f there are separate matters which involve similar issues of law or fact, or identical parties, the matters may be consolidated if it appears that consolidation would promote the just, speedy, and inexpensive resolution of the proceedings, and would not unduly prejudice the rights of a party." Staff believes that consolidation of Dockets Nos. 980670-WS and 971186-SU would promote the just, speedy, and inexpensive resolution of the proceedings, and would not unduly prejudice the rights of any party, and would be the most efficient means to resolve both dockets. Therefore, staff recommends that the Commission consolidate Dockets Nos. 980670-WS and 971186-SU.

ISSUE 2: Should Sanlando's Motion to Close Docket No. 980670-WS, filed March 13, 2000, be approved?

RECOMMENDATION: Yes, Sanlando's Motion to Close Docket No. 980670-WS, filed March 13, 2000, should be viewed as an offer of settlement and should be approved as such. Sanlando's 1999 revenues held subject to refund (\$407,009) should be charged to CIAC within 90 days of the effective date of the Commission Order. No further revenues should be held subject to refund after January 1, 2000. The Utilities, Inc. corporate undertaking which guarantees Sanlando's potential refund should be canceled. (BRUBAKER, CASEY, RENDELL)

STAFF ANALYSIS: On March 13, 2000, the utility filed a Motion to Close Docket No. 980670-WS. The Motion requests that the Commission enter an Order:

1. Requiring Sanlando to book any 1999 overearnings as CIAC;
2. As of January 1, 2000, that no earnings be held subject to refund;
3. Terminating the corporate undertaking;
4. Upon determination of 1999 overearnings, to close this docket.

The utility contends that there will be no overearnings in the year 2000 since the utility's reuse project with a current cost of \$5,831,000 will be under construction, and the utility will not be seeking a rate increase for this new construction at this time.

Upon review of the utility's motion and after discussion with the utility and OPC at the noticed conference held April 14, 2000, staff believes that regardless of the motion's caption, the motion substantially constitutes an offer of settlement by the utility of Docket No 980670-WS. Staff therefore directs its analysis and recommendation of the utility's motion as an offer of settlement.

Before considering the utility's motion, staff reviewed the utility's 1999 annual report filed with the Commission on May 2, 2000. Based on the information reported in the utility's 1999 annual report, the utility's water system overearned by \$76,980, and the utility's wastewater system overearned by \$66,958.

A review by staff of the utility's 1999 earnings showed that the utility made adjustments of \$162,635 for water, and \$408,418 for wastewater to decrease revenues to comply with Order No. PSC-00-0111-PAA-WS, issued January 12, 2000, which ordered the utility

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to charge 1997 and 1998 overearnings to CIAC. The offsetting entry the utility made was to accounts payable. The correct adjustment should have been to credit CIAC for \$138,460 for water and \$260,430 for wastewater with the offsetting entries being to retained earnings. Staff will be addressing the entries made by the utility, along with possible regulatory assessment fees owed on unreported revenues for 1999, with the utility outside the scope of Docket No. 980670-WS.

Staff recalculated the utility's 1999 revenues to include the amounts removed by the utility. After staff's adjustments, the utility's water system shows overearnings of \$249,720, and the utility's wastewater system shows overearnings of \$454,312.

In its motion, Sanlando has made an offer to charge the \$407,009 of revenues held subject to refund for 1999 to CIAC provided no 2000 earnings are held subject to refund after January 1, 2000, the Utilities, Inc. corporate undertaking guaranteeing any potential refund of Sanlando revenues is canceled, and Docket No. 980670-WS is closed. The amount held subject to refund (\$407,009) is the maximum amount recoverable by the Commission for 1999. Sanlando believes it is necessary to resolve any overearnings issue as soon as possible, so it may proceed with the reuse project with "no clouds hanging over it."

On March 24, 2000, OPC filed a "Citizen's Response to Sanlando's Motion to Close Docket No. 980670-WS." The response states:

OPC strongly objects to Sanlando's motion to close Docket No. 980670-WS. There has been no showing that Sanlando will not overearn in the year 2000. While OPC acknowledges that Sanlando may add a substantial investment to its rate base and incur additional operating costs associated with the reuse project, these potential added costs in no way demonstrate that there will be no overearnings in the year 2000. Such a finding can only be made after the year 2000 has closed and there is a full investigation by the Commission. In addition, the costs to which Sanlando refers are subject to approval by the Commission and may change over time, as they have in the past. Likewise, there is no guarantee that Sanlando will incur the proposed capital expenditures during 2000. It is possible the project will be delayed as it has been on numerous occasions in the past. The Commission should not abandon its overearnings investigation merely because Sanlando

suggests that no overearnings will occur. To the contrary, the Commission should do a full investigation of any possible overearnings at the completion of the year 2000. Similarly, the Commission should hold the year 2000 earnings subject to refund. To do otherwise, would jeopardize ratepayers access to potential overearnings.

Staff analyzed the utility's earnings on a prospective basis after the reuse project will be installed. The utility has provided a date of June 2000 for commencement of the construction of the new reuse plant. After inclusion of the new reuse plant, staff calculated that the utility will overearn on the water system by \$257,625, and underearn on the wastewater system by \$759,853, for net underearnings of \$502,228, using staff's recommended rate of return on equity of 9.81%. (addressed in Issue No. 3)

Sanlando's amended application for approval of reuse project plan, filed March 10, 2000, states "Sanlando does not presently propose to recover the cost of the reuse project through rates. However, the investment will eliminate any question of overearnings which is pending before the Commission in Docket No. 980670-WS."

Staff believes that the utility has provided ample evidence that it will not be overearning once the reuse plant project is initiated, and that acceptance of the utility's offer would be in the customers' best interests. Staff recommends that Sanlando's Motion to Close Docket No. 980670-WS, filed March 13, 2000, be approved, that Sanlando 1999 revenues held subject to refund (\$407,009) should be charged to CIAC within 90 days of the effective date of the Commission Order, that no further revenues should be held subject to refund after January 1, 2000, and that the Utilities, Inc.'s corporate undertaking guaranteeing Sanlando's potential refund, should be canceled. The portion of the motion concerning the closing of the docket is addressed in Issue No. 5 of this recommendation.

ISSUE 3: What is the appropriate rate of return on equity for Sanlando Utilities, Inc.?

RECOMMENDATION: The appropriate rate of return on equity for Sanlando Utilities, Inc. should be 9.81%, with a range of 8.81% to 10.81%. If any future full investigation of the utility's books and records and quality of service reveals necessary adjustments, staff believes the Commission should not be bound to adjustments made in this proceeding. (CASEY)

STAFF ANALYSIS: By Order No. PSC-00-0111-PAA-WS, issued January 12, 2000, the Commission established Sanlando's rate of return on equity (ROE) as 10.12%, with a range of 9.12% to 11.12%. The Commission also put the utility on notice that a new ROE would be established on a going-forward basis, using a capital structure reflecting the change of majority control to Utilities, Inc. once 1999 earnings were reviewed. Staff calculated Sanlando's new ROE by using Utility Inc.'s average capital structure for the years ending December 31, 1998, and December 31, 1999, and adding Sanlando's customer deposits.

The capital structure consists of \$53,940,615 of equity, long term debt of \$50,497,779 with cost rates ranging from 6.31% to 10.39%, notes payable of \$15,262,483 at a cost of 7.38%, and \$153,357 of customer deposits at a cost of 6.00%. The rate of return on equity, when based on the leverage graph formula established in Order No. PSC-99-1224-PAA-WS, issued June 21, 1999, in Docket No. 990006-WS, is 9.81% with a range of 8.81% to 10.81%.

The components of the capital structure used to calculate the ROE in this proceeding are unaudited. If any future full investigation of the utility's books and records and quality of service reveals necessary adjustments, staff believes that the Commission should not be bound to adjustments made in this proceeding.

This recommended ROE should be effective as of the date the Commission's order is final and should be applied to any future proceedings of this utility, including, but not limited to, price indexes, interim rates, and overearnings.

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ISSUE 4: Should Sanlando Utilities Corporation's proposed reuse plan be approved?

RECOMMENDATION: Yes, the Commission should approve the utility's amended reuse project plan filed March 10, 2000. (CASEY, RENDELL, BRUBAKER)

STAFF ANALYSIS: By Order No. PSC-00-0112-PAA-SU, issued January 12, 2000, the Commission ordered Sanlando to file a revised reuse project application within six-months of the effective date of that order. On March 10, 2000, Sanlando filed an "Amended Application for Approval of Reuse Project Plan." The amended plan calls for Sanlando to interconnect with the City of Altamonte Springs' reuse system, along with offering reuse to two golf courses, two homeowner's associations common areas, and a commercial nursery.

The latest estimate of the cost of the reuse project is \$5,831,000. The utility also estimates its operating costs will increase by \$410,275 annually. The utility does not propose to recover the cost of the reuse project through rates. It believes its investment will eliminate any question of Sanlando overearnings for the year 2000 and beyond. Construction is scheduled to commence this month, and be completed by the end of 2001.

Because the utility has complied with Order No. PSC-00-0112-PAA-SU, by filing its amended application for approval of reuse project plan, and the utility is not requesting recovery of the costs of the reuse project in its application, staff is recommending approval of the utility's reuse project plan filed March 10, 2000.

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ISSUE 5: Should Dockets Nos. 980670-WS and 971186-SU be closed?

RECOMMENDATION: Yes. If the Commission approves staff's recommendations in Issues 1-4 of this recommendation, Dockets Nos. 980670-WS and 971186-SU should be closed upon the issuance of a Consummating Order if no person whose interests are substantially affected by the proposed action files a protest within the 21 day protest period. (BRUBAKER, CASEY, RENDELL)

STAFF ANALYSIS: If the Commission approves staff's recommendations in Issues 1-4 of this recommendation, Dockets Nos. 980670-WS and 971186-SU should be closed upon the issuance of a Consummating Order if no person whose interests are substantially affected by the proposed action files a protest within the 21 day protest period.